APPENDIX 3

EXHIBITS

EXHIBIT II-1

Strategic Petroleum Reserve

Business Procedures

Crude Oil Exchanges

SPRPMO 0015
January 2002

INTRODUCTION

The Energy Policy and Conservation Act authorizes the Strategic Petroleum Reserve (SPR) to acquire oil by use of exchanges. The SPR has exercised this authority in two different ways over the last several years. First, crude oil from the Reserve is exchanged for a larger quantity and/or better quality of crude oil. Second, crude oil owed to the Government as royalty under Federal leases, administered by the Minerals Management Service of the Department of Interior, is exchanged for oil to be delivered to the SPR. These latter exchanges are commonly referred to as the Royalty-In-Kind (RIK) Program

Although the Federal Acquisition Regulation, the Department of Energy Acquisition Regulation, and the SPR Standard Sales Procedures do not govern the SPR crude oil exchanges, many of their underlying contracting principles are applicable. Within this context, these procedures outline the business framework for the SPR crude oil exchange activities.

SOLICITATION

1) Development of Source List

   The email notification list for notifying firms of exchange solicitations is established by compiling selected names of firms listed on the Sales Offer Mailing List developed for drawdown; firms expressing interest or awardees on previous exchange solicitations; and telephone requests for inclusion on the email notification list.

2) Preparation

   i) The Acquisition and Sales Division (A&SD) initially develops a tentative schedule for solicitation milestones. Coordination with the Program Office's (PO) Operations and Readiness Office, and the Project Management Office (PMO) Crude Oil, Drawdown Readiness, and Cavern Integrity Division (Crude Oil Division) is conducted to finalize the solicitation schedule prior to submission for review and approval by the PMO Project Manager.

   ii) A&SD develops the boilerplate solicitation and incorporates logistical information from the Program Office, Crude Oil Division, Planning and Financial Management Division (Finance) and DynMcDermott's Crude Oil Logistics (DMCOL) organization. This information includes site specific scheduling of crude oil receipts;

special requirements such as site and quality constraints; quantity determinations; and any other pertinent information necessary to provide potential offerors as much information as is available.

3) Review and Approval

The A&SD coordinates final review with and obtains concurrence from the Director, Acquisition and Sales Division, the APM for M&A, PO, Crude Oil Division, Finance and Legal counsel. Once the solicitation has been finalized, required coordination completed and concurrences obtained, the PMO Project Manager authorizes the release of the solicitation, which is issued via posting on the SPR web page.

4) Issuance of Solicitation

A&SD coordinates with the PMO Information Systems and Technical Services Division (IS) for posting of the solicitation on the SPR web page. IS also establishes an email address for submission of questions pertaining to the solicitation. A&SD, Crude Oil Division, Finance, Legal Counsel, PO and DMCOL coordinates responses to questions submitted concerning the solicitation and A&SD posts questions and answers on the web page.

5) Major Business Considerations

i) Offer Guarantee

Offerors are required to provide an acceptable offer guarantee Letter of Credit (LC) with their offer(s) (amount determined to be sufficient to protect the Government's interest will be stipulated in the solicitation). Rational for determination of LC amount will be documented in the solicitation file. This offer guarantee shall be in the form of an irrevocable standby letter of credit from a U.S. depository institution located in and authorized to do business in the U.S., established in favor of the U.S. Department of Energy and must be valid for at least 30 calendar days. The offer guarantee ensures that 1) the offeror must abide by its offer for the stipulated offer period and 2) protects the Government from damage should contractor fail to provide an acceptable performance letter of credit after contract award.

Performance Guarantee

Performance guarantees are required after contract award (normally within five business days) in an amount determined by the terms and conditions set forth in the contract. The LC amount shall be sufficient to protect the Government's interest and the rational for determination of LC amount will be documented in the contract file. The performance guarantee shall be in the form of an irrevocable standby letter of credit from a U.S. depository institution located in and authorized to do business in the U.S. and established in favor of the U.S. Department of Energy. The Performance Guarantee is established to protect the Government from 1) default of the contractor to deliver amounts of crude oil owed the Government, or 2) failure of the contractor to make final reconciliation payment to the Government.

ii) Evaluation Criteria

Evaluation criteria are developed with coordination of A&SD, Crude Oil Division, PO and DMCOL personnel prior to receipt of offers. The criteria will be structured to facilitate expeditious evaluation of offers. Evaluation criteria are developed based on best value to the Government considering the return ratio offered and the value of the oil being offered in exchange. Specific factors could include site storage requirements, oil quality, oil quantity, return schedule, and logistics (e.g. transportation, terminalling, etc.).

iii) Closing Date

The closing date for the solicitation usually is established as two weeks (14 days) from issuance. However, this duration period could change should there be programmatic reasons such as collaboration with Mineral Management Service requirements.

EVALUATION AND AWARD

1) Evaluation Procedures

Following receipt of timely offers at closing, A&SD conducts an initial review to determine if each offer has an offer guarantee, required certifications, completed offer form and signed contract form. Failure to provide required documentation with offer may result in rejection of the offer as nonresponsive. A&SD also forwards offer documentation to the Office of Chief Counsel for legal sufficiency review and forwards offer guarantee(s) to the Planning and Financial Management Division (Finance) for determination of acceptability.

An evaluation team led by the Crude Oil Division and consisting of personnel from A&SD, PO, and DMCOL, as well as support from crude oil industry consultant(s), conducts a review of the responsive offers. The team evaluates each offer using the evaluation criteria established in the solicitation.

2) Responsibility Determination

Upon receipt of offers a review is conducted by A&SD to determine the responsibility of companies submitting an offer. Although the offer submits an offer guarantee this alone does not determine a company responsible for the purpose of fulfilling the requirements of the contract. Other factors used in making this determination include whether the firm is considered a regular seller, purchaser or trader of crude oil; demonstrated oil movement experience; and has the financial capability to perform in accordance with the terms of the contract. The last may require a financial review of the firm, including a credit check (e.g., a Dun & Bradstreet report).

3) Offer guarantee review

Upon receipt at solicitation closing, A&SD forwards offer guarantee LCs to Finance for review of acceptability of financial institutions, accuracy in format and amount, and proper signatures with acceptable backup documentation pursuant to the SPR Business Process for Handling Letters of Credit procedures. Finance confirms acceptability or identifies discrepancies in offer guarantees and coordinates with Legal Counsel. Notification by Finance is provided A&SD via email concerning acceptability of LCs. Minor informalities in the offer guarantees will be resolved by A&SD and the offeror. Failure in the timely correction of offer LC will result in offer being rejected.

4) Written or oral discussions

The evaluation team will review each offer utilizing evaluation criteria established to determine reasonableness. Offers determined to be reasonable and acceptable will be awarded base on initial offers without discussions provided that the Contracting Officer has made a favorable determination of responsibility. However, if no awards or only partial award of available Royalty Oil is made on initial offers, a determination will be made by the Contracting Officer for conducting discussions with firms submitting offers that could be made acceptable. Since crude oil quotes are time sensitive normally oral discussions are conducted.

5) Review and approval

Upon completion of discussions and/or determination of reasonableness of initial or final offers the evaluation team briefs the PO and PMO senior staff. Based on this briefing a determination of final approval is made. All proposed crude oil exchange awards over $1,000,000 require the prior approval of the Project Manager, which will typically be done via email to the Contracting Officer.

6) Award

Upon notification of final approval the Contracting Officer signs the contract form and notifies the awardees. Copies of the award documents will be forwarded to the awardees as well as internal distribution.

CONTRACT ADMINISTRATION

1) Review and approval of performance guarantee

Performance guarantee LCs are required after award of the contract (normally within five business days). Upon receipt by A&SD performance guarantees are forwarded to Finance for a review of acceptability. Finance reviews acceptability of financial institutions, accuracy in format and amount, and proper signatures with acceptable backup documentation pursuant to the SPR Business Process for Handling Letters of Credit procedures. Finance notifies A&SD of approval or identification of discrepancies (after coordination with Legal Counsel) of each performance guarantee via email. The Contracting Officer notifies contractors of discrepancies and provides an opportunity to make the LCs acceptable. Failure to provide an acceptable LC will result in a termination of the contract and the Offer Guarantee LC will be drawn upon for any subsequent damages to the Government.

2) Contract Modifications

i) Deferrals or accelerations

During contract performance there may be situations when due to programmatic requirements or through contractor request the schedule for the delivery of exchange oil to the SPR sites are proposed to be deferred to a later date or accelerated to an earlier date. An evaluation is performed incorporating a formula that encompasses market conditions including crude oil prices from contracted delivery period to the revised delivery period, time value of money and crude type differentials. Based on this evaluation negotiations are conducted with the contractor with a team consisting of A&SD, Crude Oil Division, PO and DMCOL personnel. Based on the negotiated agreement a bilateral modification is executed by AS&D and the contractor incorporating the revised delivery schedule; any additional premium barrels owed by the contractor as a result of the agreement; and the requirement for an amended LC (normally due within five business days) extending the expiration date and/or the value of the LC, as applicable. Coordination with Finance on the revised LC will be performed upon receipt.

ii) Quantity or quality adjustments

Due to potential variances in cargo volumes and/or quality variances of crude oil received at the SPR sites, contract provisions allow for adjustments for these variances. Based on DD250s or DD250-1s the contractor may owe additional barrels as a result of the under delivery of contracted amounts. Depending on the amount of the shortage the contractor may owe the Government interest, which is computed in accordance with the terms of the contract. In addition, the contract provides quality variance payment adjustments for crude oil determined by analysis to not meet contractual requirements. Payment is requested in the form of additional barrels unless it is not feasible due to insufficient quantities, then monetary payment is required.

iii) Performance guarantee monitoring and adjustments

A&SD forwards all original performance guarantee LCs to Finance where they are maintained in a secure container. Finance maintains and updates on a monthly basis a spreadsheet identifying all exchange contractors, contract monetary value, LCs associated with each, and sufficiency of each LC to the contract value. Briefings are made to Senior Staff as necessary concerning the status of guarantees under the exchange contracts. The Contracting Officer shall immediately notify (via email) the Assistant Project Manager for Management and Administration and the Project Manager when a performance guarantee does not meet contract requirements or will expire prior to final delivery.

Based on contact value increase due to additional barrels for deferral or acceleration considerations the amount or period of coverage of the LC may be revised. Upon receipt of the revised LC A&SD forwards the original to Finance.

iv) Reviews and approvals

Modifications to exchange contracts are coordinated with senior staff, Crude Oil Division, DMCOL and PO prior to execution. Copies of all modifications are provided to Finance, Crude Oil Division, DMCOL and PO. Modifications over $1,000,000 or that impact delivery dates by more than 30 days require the prior approval of the Project Manager, which typically will be done via email to the Contracting Officer.

3) Deliveries

Exchange oil delivered to the SPR sites undergoes API gravity, quality and Sediment and Water tests to determine delivered quantity. Quantity measurements are performed and certified by the Government's representative at the delivery point. Also, title to the crude oil is transferred to DOE at the custody transfer measurement locations specified in the exchange contract.

Within 30 days after contract award, the Contractor(s) are required to submit a monthly delivery schedule to each SPR delivery location to the Contracting Officer for approval. This delivery schedule may allow for economic delivery-size marine cargos and/or commercial pipeline batch shipments (not less than 50,000 barrels per batch), to be spaced within the constraints of the SPR site receipt capabilities. The Contracting Officer must approve any changes to the original delivery schedule.

CONTRACT CLOSEOUT

After completion of the final scheduled delivery under the contract an inventory closeout reconciliation is conducted to determine if any imbalances exist between quantity due and what was delivered. If in the final analysis the SPR owes the contractor a monetary settlement, Finance, with the proper approvals within the SPR, will notify the U.S. Treasury for disbursement. Should, after final analysis, the contractor owes the SPR an amount which is insufficient to pay in additional crude oil, Finance will submit an invoice to the contractor for the value of the crude oil owed. Should the contractor fail to pay in the specified time the amount will be drawn for the contractor's LC. This procedure also applies to quality differential imbalances. Upon the satisfactory completion of all terms and conditions of the contract the contractors LC is returned to the issuing financial institution.

The value of the crude oil imbalance is determined by data published on the Platt's Oilgram Price Report and the Average Freight Rate Assessment valued on the last delivery date.

FINANCIAL ACCOUNTING

1) Accounts Receivable

For RIK accounts receivable, the quantities owed are recorded at current market value for the type of crude involved (i.e., sweet or sour). Amounts outstanding at the end of each fiscal year are adjusted to reflect current market value at that point in time. For exchanges of oil from the Reserve, the portion of the quantity owed that matches the quantity delivered from the SPR is recorded at the value assigned to that oil when it was stored in the Reserve. The quantities owed that are in excess of the quantities delivered from the SPR (i.e., premium portion) are recorded at current market value. At the end of each fiscal year, the outstanding premium portions are adjusted to reflect the current market value at that point in time. The accounts receivable are appropriately reduced as deliveries are made to the SPR. The SPR Business Process – Oil Inventory desktop procedure details steps for recording and reporting accounts receivables.

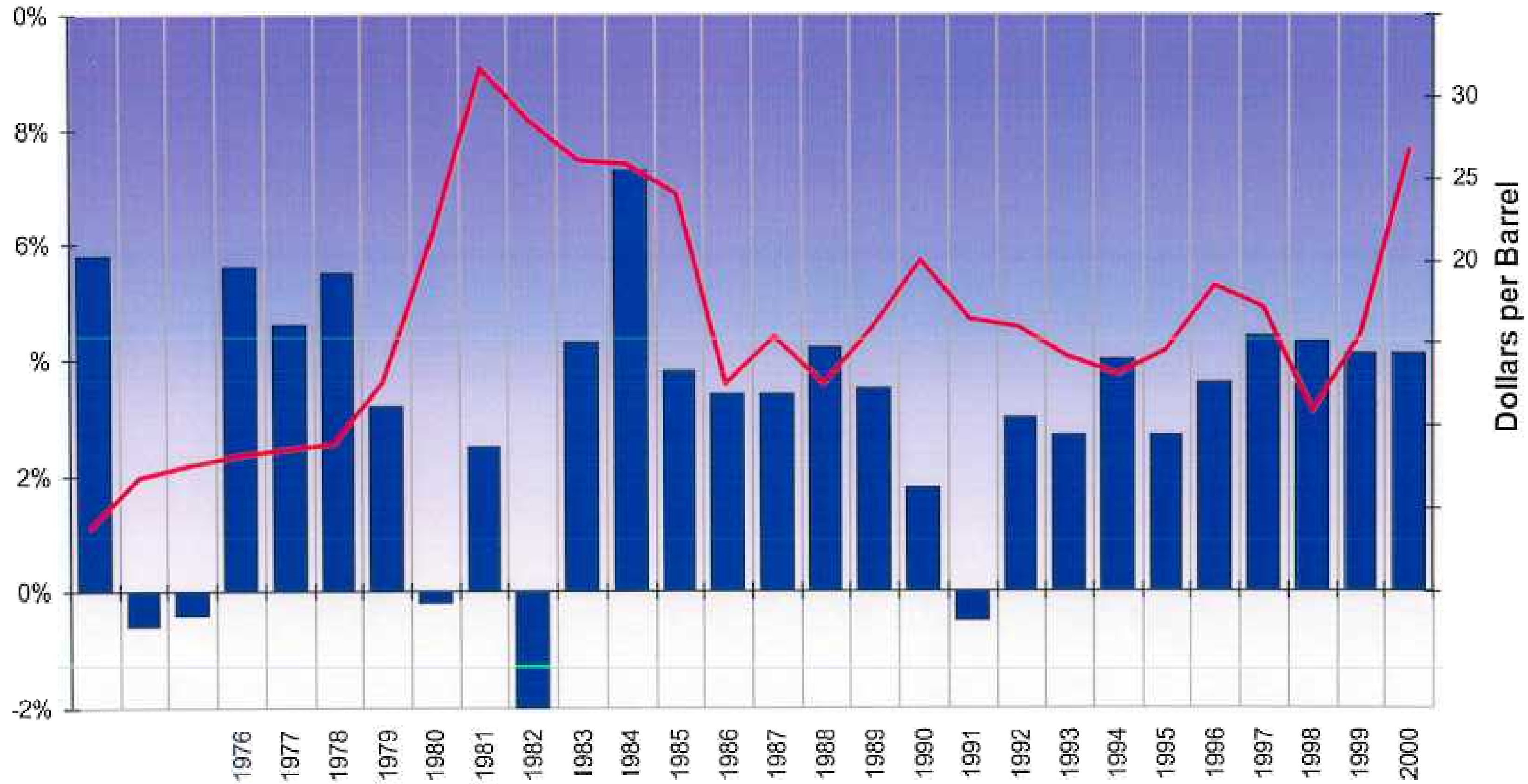
STRATEGIC PETROLEUM RESERVE

APEC WORKSHOP ON ENERGY SECURITY POLICY

John Shages

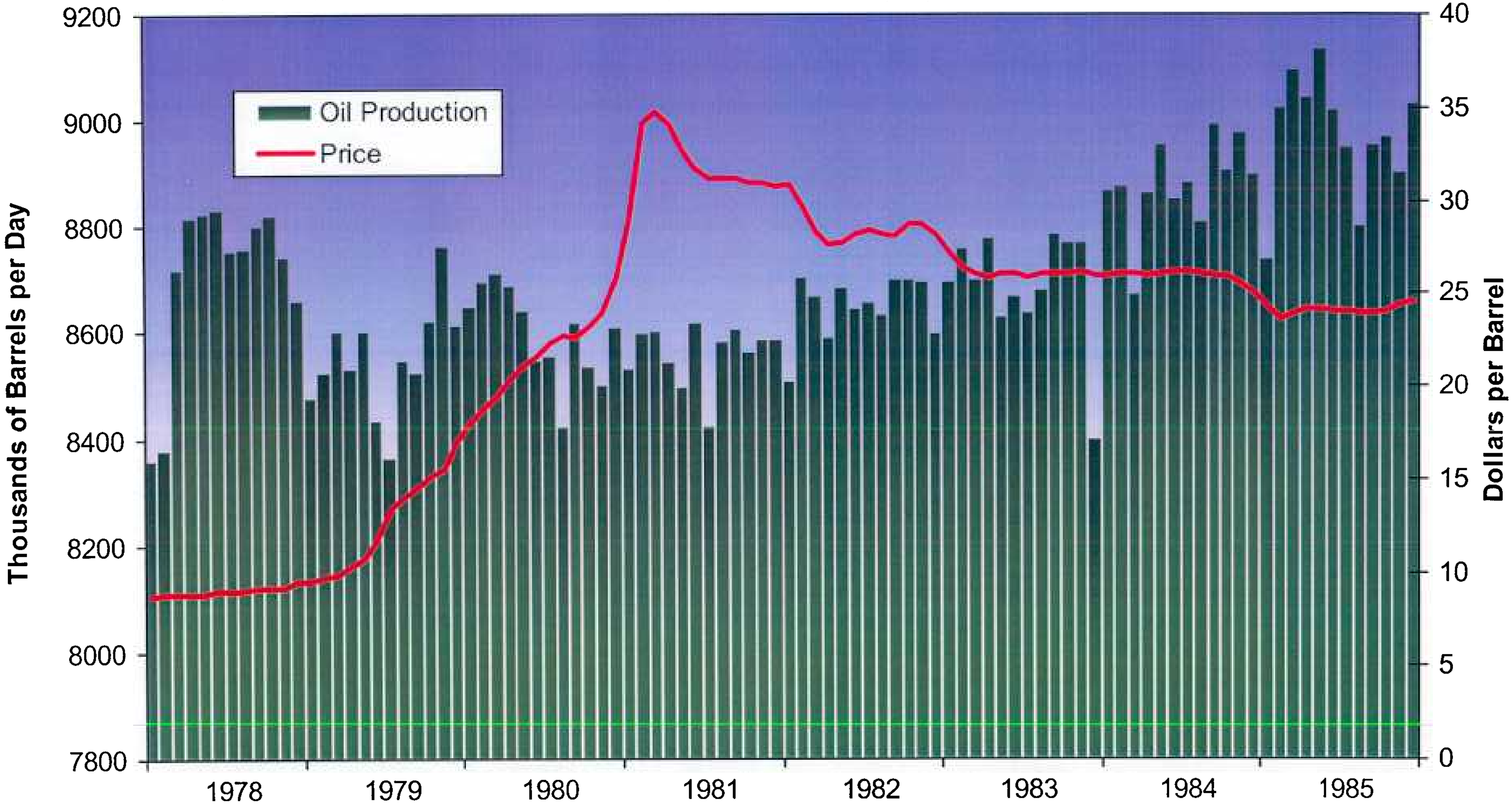
EXHIBIT II-2

Gross Domestic Product
Percent Change From Preced ng Period
Seasona ly Adjusted Annua Rates)



.ppt

US Crude Oil Production And Wellhead Prices



SPR2670.ppt

United States Policy on Responding to Oil Supply Disruptions

- The policy of the United States regarding oil supply disruptions is to rely on market forces to allocate supply, and to ordinarily supplement supply by the early drawdown of the Strategic Petroleum Reserve in large volumes and in coordination with our allies and trading partners.

Critical Elements to Justify a Drawdown

- A Disruption Event
- Evidence of Supply Stress
- A Price Spike

The Key To A Successful Strategic Reserve Is Cost Control

- The benefits come with a drawdown – but the number and extent of futures disruptions is unknown.
- Measuring the degree of damage from a disruption, and the consequent benefits of a petroleum reserve, to an individual economy is an uncertain science.
- Cost is the easiest aspect to control and has the highest probability of making the Reserve cost beneficial.

Major Cost E ements

Cap Co nc ud ng and, fac ınd
ogı c y m:

Ma n enanc Co

O Acqu on Co

Capital Costs

- Dependent on location.
- Technology and type of storage facilities.
- Refer to the 1999 APERC Study supported by conceptual designs and cost estimates from PBKBB, Inc.

Lessons Learned to Control Oil Acqu sit on Costs

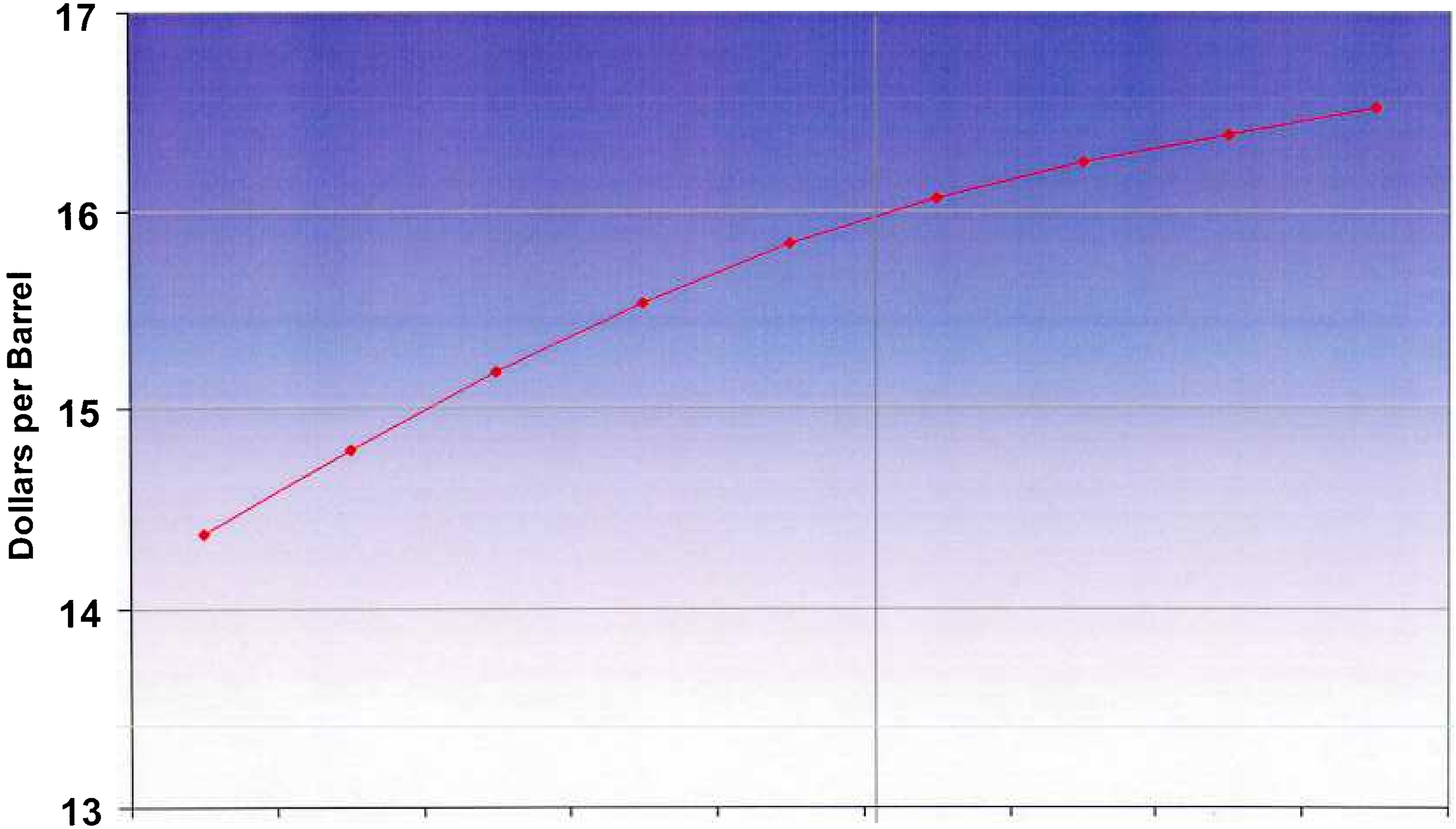
Le h mark d rm ne your buying p tt rn

Buy n weak mark

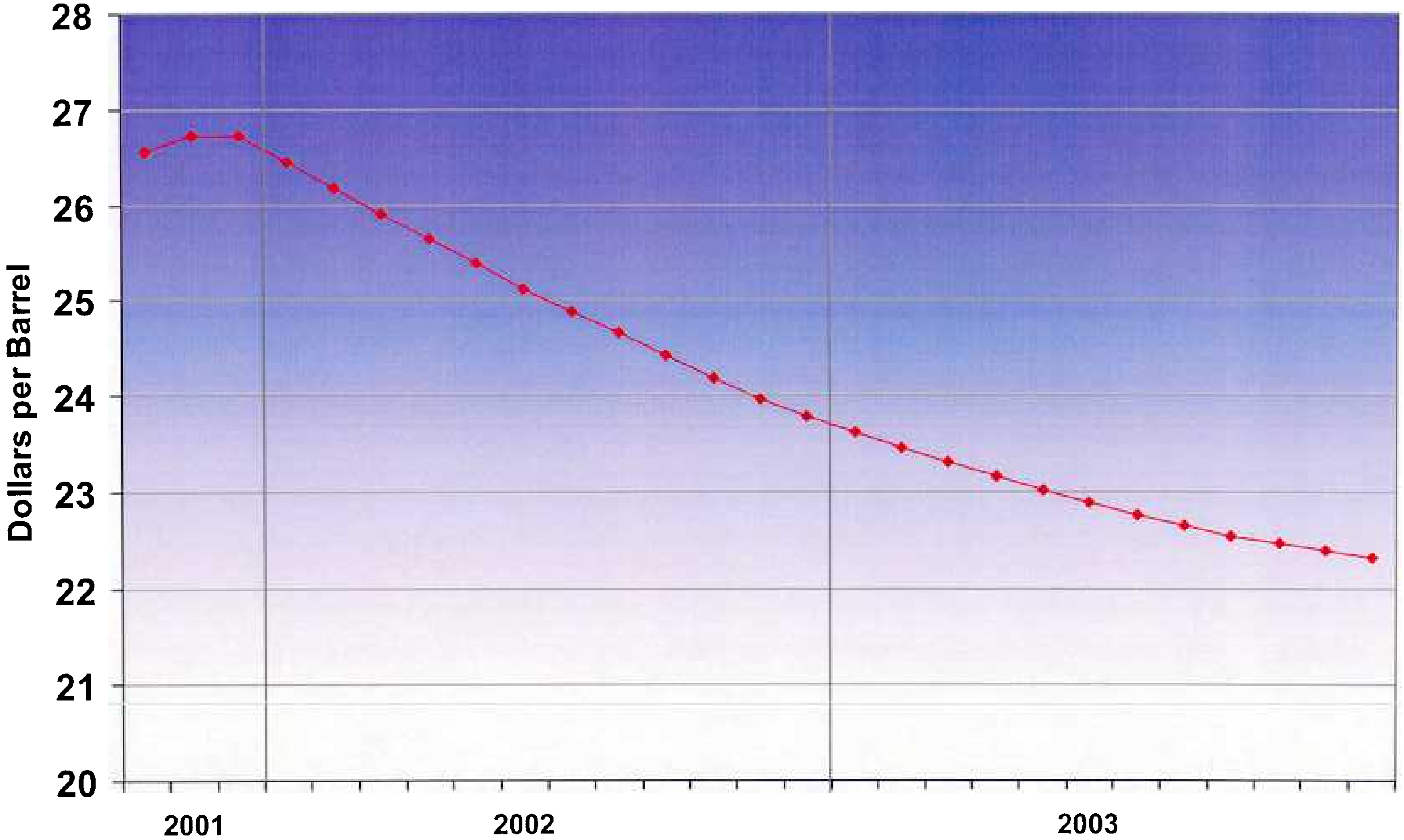
D ay de v ri during trong marke

U e your acqu on trat gy o tab ze mark

Example of "Contango" Futures Market
NYMEX July 1, 1998 Closing Prices

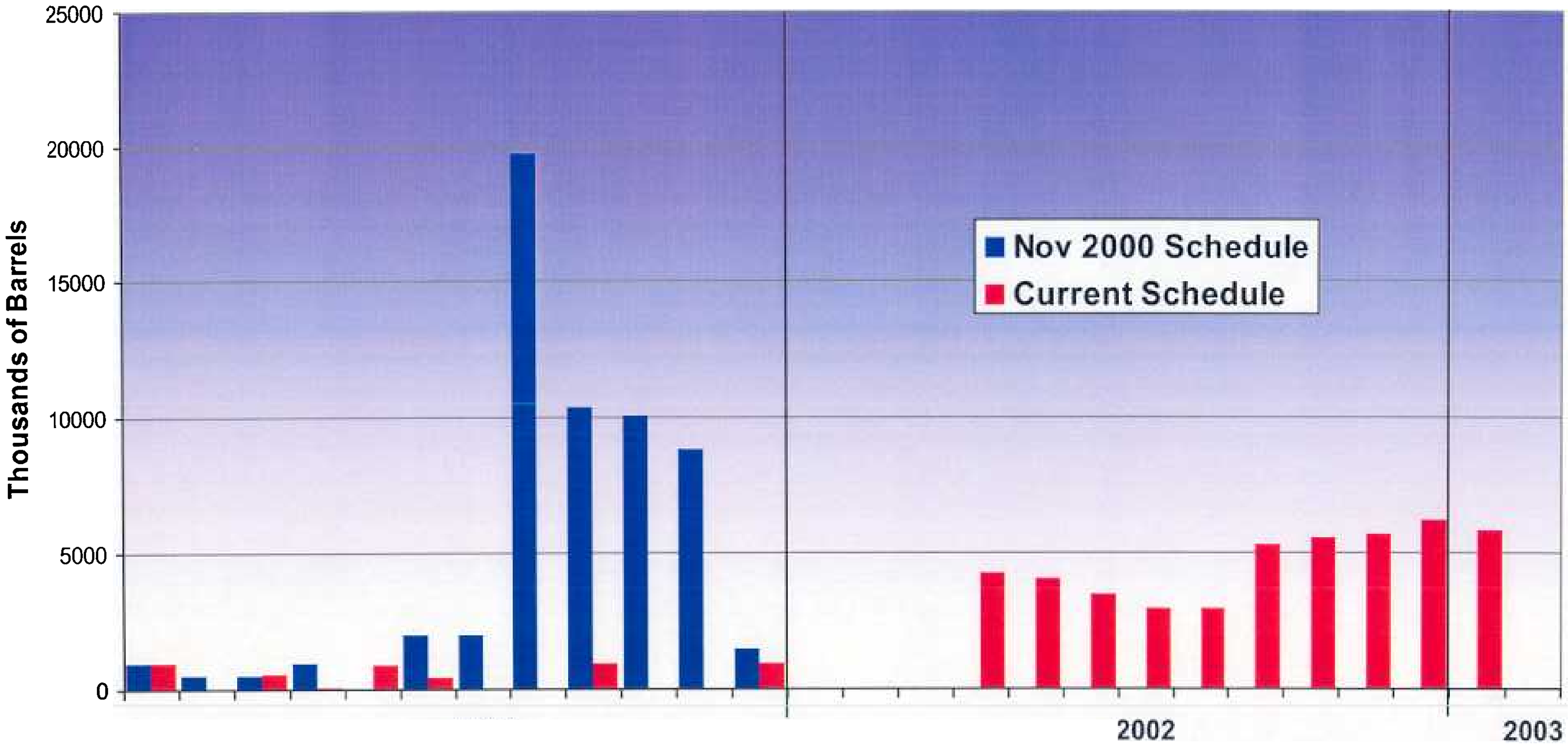


Example of "Backwardated" Futures Market
NYMEX August 30 Closing Prices

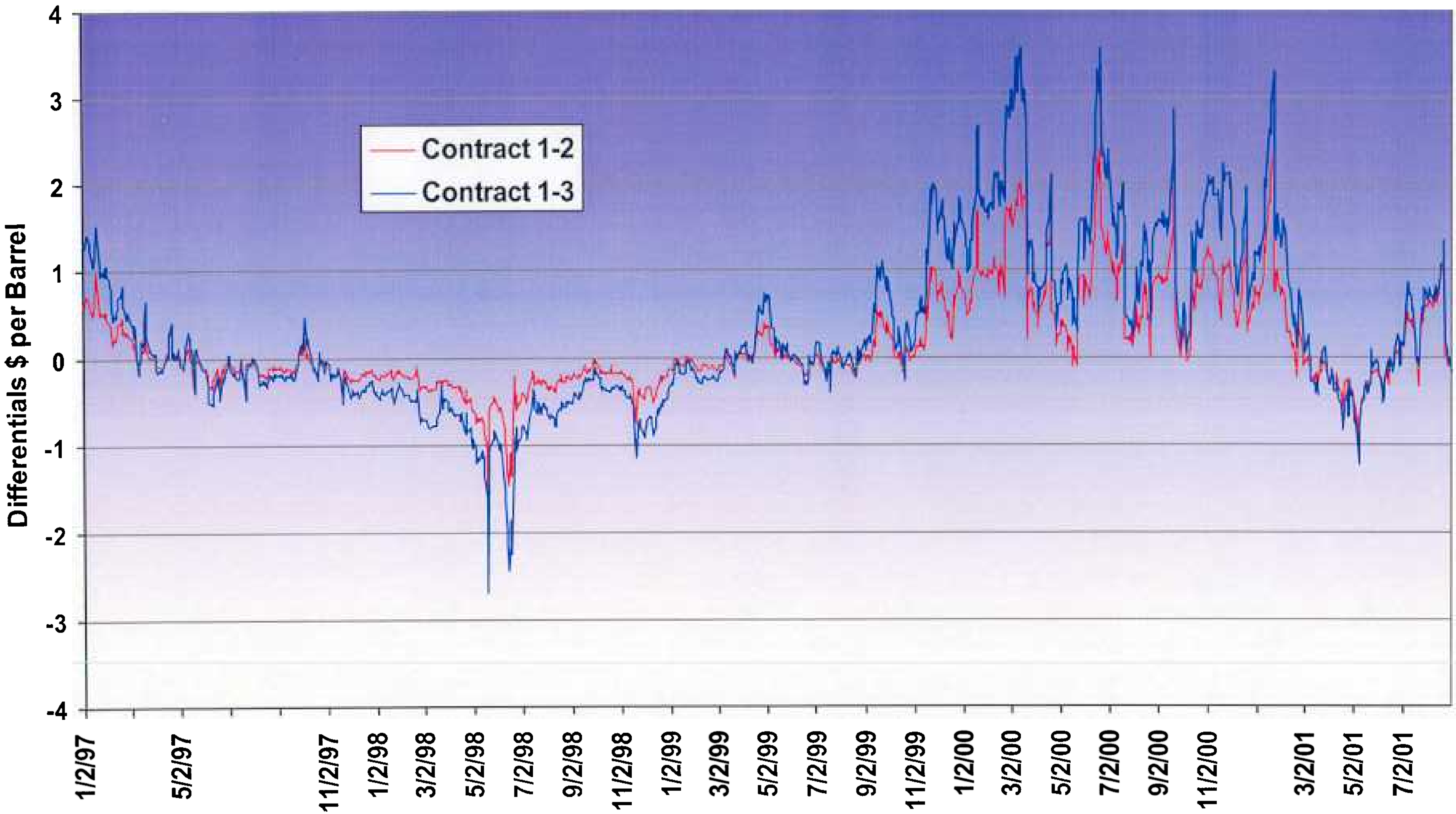


SPR2670.ppt

SPR Delivery Schedule



NYMEX Price Differentials
Near Month vs. One and Two Month Later



SPR2670.ppt

New York Mercantile Exchange

West Texas Sour Crude Oil Futures

Contract Detail
- Description
- Specification
- Margins
- Settlements
- Terms & Conditions
- ClearPort^sm Overview
- Other Products

Contract Unit:
1,000 barrels.

Price Quotation:
U.S. dollars and cents per barrel

Business Hours:
Trades may be entered on the Exchange OTC website for clearing Monday through Friday, between the hours of 7:30 A.M. and 2:30 P.M., New York time.

Trading Venue:
Over-the-counter

Listed Months
The contract is listed for up to 18 months

Termination of Trading:
Third business day prior to the 25th calendar day of the month preceding the contract month. If the 25th calendar day is a non-business day, trading terminates on the third day prior to the last preceding business day.

Settlement Type:
Physical delivery at Midland, Texas.

Trading Symbol:
TS

EXHIBIT III-1

238

New York Mercantile Exchange

>> Exchange Sets Record for NYMEX Division Seat Sale

Contact Us | Glossary

Search go

Login please select one go

Light Louisiana Sweet Crude Oil Futures

Contract Detail
- Description
- Specifications
- Margins
- Settlements
- Terms & Conditions
- ClearPort^{sm} Overview
- Other Products

Contract Unit:
1,000 barrels

Price Quotation
U.S. dollars and cents per barrel.

Business Hours:
Trades may be entered on the Exchange OTC website for clearing Monday through Friday, between the hours of 7:30 A.M. and 2:30 P.M., New York time.

Trading Venue:
Over-the-counter

Listed Months:
Up to 18 months.

Last Trading Day:
Third business day prior to the 25th calendar day of the month preceding the contract month. If the 25th calendar day is a non-business day, trading terminates on the third day prior to the last preceding business day.

Settlement:
Physical delivery at St. James, Louisiana.

Trading Symbol:
LS